
FISCAL POLICIES MANUAL	1
EXPENDITURES: INDEPENDENT CONTRACTOR/EMPLOYEE.....	1
PREFACE.....	1
DEFINITION.....	1
POLICY.....	5
FISCAL IMPACT	5
ADMINISTRATIVE PROCEDURES	6

FISCAL POLICIES MANUAL

EXPENDITURES: INDEPENDENT CONTRACTOR/EMPLOYEE

PREFACE

IRS continues to place strong emphasis on the status of workers nationwide. The issue of employee versus independent contractor/consultant is one of which all state agencies must be keenly aware. Agency management must make every effort to ensure the State of Idaho is not placed in a position of liability as a result of improper worker classification.

DEFINITION

The Social Security Administration (SSA) has created the "Common Law Test" to determine worker status. The SSA test contains twenty-two, long-standing criteria for determining the proper worker status and is found in Chapter 8 of the Federal Social Security Handbook, Sections 803 through 824. The SSA criteria are as follows:

803. UNDER THE COMMON-LAW TEST, WORKERS ARE EMPLOYEES if the person for whom they work has the right to tell them what to do and how, when, and where to do it. The employer does not have to give these orders, but needs only the right to do so.
804. THE FACTORS OR ELEMENTS SHOWING CONTROL over details of work are discussed in sections 805-824. The factors are to be weighed against or compared to those which point to an independent contractor status. Any single fact or small group of facts is not conclusive evidence of the presence or absence of control. All facts must be weighed and the conclusion must be based on a careful evaluation of all the facts and the presence or absence of factors which point to an employer-employee relationship, as well as those which point to an independent contractor status.

The weight to be given to the factors discussed in the following sections is not always constant. Their degree of importance may vary somewhat depending on the occupation being considered and the reasons for their existence. Some of them do not apply to particular occupations.

805. A PERSON REQUIRED TO COMPLY WITH INSTRUCTIONS about when, where, and how to work is ordinarily an employee. Some employees may work without receiving instructions because they are highly proficient in their line of work and they can be trusted to work to the best of their abilities. However, the control factor is present if the employer has the right to instruct. Instructions may be oral or they may be in the form of manuals or written procedures, showing how the desired result is to be accomplished.
806. TRAINING of a person by an experienced employee is a factor of control because it is an indication the employer wants the services performed in a particular method or manner. This is especially true if the training is given periodically or at frequent intervals. Independent contractors ordinarily use their own methods and receive no training from the purchasers of their services.
807. INTEGRATION of the person's services in the business operations generally shows the person is subject to direction and control. In determining whether integration exists, it is necessary to determine the scope and function of the business and then to determine whether the services of the individual are merged into it. When the success or continuation of a business depends to an appreciable degree upon the performance of certain kinds of services, the people who perform those services must necessarily be subject to a certain amount of control by the owner of the business.
808. IF THE SERVICES MUST BE RENDERED PERSONALLY, it indicates that the employer is interested in the methods as well as the results. The employer is interested not only in getting a desired result, but also in who does the job. Lack of control may be indicated when an individual has the right to hire a substitute without the employer's knowledge.
809. HIRING, SUPERVISING AND PAYING ASSISTANTS by the employer generally shows control over all the workers on the job. Sometimes one worker may hire, supervise and pay the other workers, because of a contract under which the worker provides materials and labor and is responsible only for the attainment of a result. In such instances, the worker is an independent contractor. On the other hand, if the worker hires, supervises and pays other workers at the direction of the employer, the worker may be acting as an employee in the capacity of a supervisor for, or representative of, the employer.
810. THE EXISTENCE OF A CONTINUING RELATIONSHIP between an individual and the person for whom the individual performs services is a factor tending to indicate the existence of an employer-employee relationship. Continuing services may include work performed at frequently recurring, although somewhat irregular, intervals, either on call of the employer or whenever the work is available. This type of relationship is considered permanent if continuing or recurring work is contemplated, even if the services are performed on a part-time basis; are seasonal; or the person actually works only a short time.

811. THE ESTABLISHMENT OF SET HOURS OF WORK by the employer is a factor indicative of control. This condition bars the worker from setting his or her own time, which is a right of the independent contractor. Where fixed hours are not practical because of the nature of the occupation, a requirement for the worker to work at certain times is an element of control.

812. IF THE WORKER MUST DEVOTE FULL TIME TO THE BUSINESS of the employer, the employer has control over the amount of time the worker spends working. By implication, this restricts the worker from doing other gainful work. An independent contractor, on the other hand, may choose both for whom and when to work.

"Full-time" does not necessarily mean an 8-hour work day or a 5- or 6-day work week. The meaning of "full-time" may vary with the intent of the parties, the nature of the occupation, and the customs in the locality. These varying conditions should be considered in defining "full time".

Full-time services may be required even though not specified in the written or oral agreement; for example, a worker may not be permitted to work for anyone else, or a worker may have to meet a production minimum, which can only be met by devoting all working hours to that business.

813. DOING THE WORK ON THE EMPLOYER'S PREMISES is not control in itself; however, it does imply the employer has control; especially where the work is of such a nature it could be done elsewhere.

A person working in the employer's place of business is physically within the employer's direction and supervision. The use of desk space and of telephone and stenographic services provided by an employer places the worker within the employer's direction and supervision, unless the worker has the option to use or not to use these facilities.

Work done off the premises does indicate some freedom from control; however, working off premises does not by itself mean that the worker is not an employee. In some occupations the services are necessarily performed away from the premises of the employer. This is true, for example, of employees of construction contractors.

814. IF A PERSON MUST PERFORM SERVICES IN THE ORDER OR SEQUENCE SET by the employer, indications are the worker may be subject to control; as the worker is not free to follow his or her own pattern of work, but must follow the established routines and schedules of the employer.

Often, because of the nature of an occupation, the employer either does not set the order of the services or sets them infrequently. However, the employer retaining the right to control is sufficient to show control exists.

815. IF REGULAR ORAL OR WRITTEN REPORTS MUST BE SUBMITTED to the employer, indications are control exists, in that the worker is compelled to account for his or her own actions.

816. AN EMPLOYEE IS USUALLY PAID BY THE HOUR, WEEK OR MONTH; whereas, payment on a commission or job basis is customary when the worker is an independent contractor. Payment by the job includes a lump sum, computed by the number of hours required to do the job at a fixed rate per hour. Also included may be weekly or monthly payments, if such periodic payments are a convenient way of paying a lump sum agreed upon as the cost of doing a job.

The guarantee of a minimum salary or the granting of a drawing account at stated intervals, with no requirement for repayment of the excess over earnings, tends to indicate the existence of an employer-employee relationship.

817. PAYMENT BY THE EMPLOYER OF THE WORKER'S BUSINESS AND/OR TRAVELING EXPENSES is a factor indicating control over the worker. Conversely, a lack of control is indicated when the worker is paid on a job basis and has to take care of all incidental expenses.

818. THE FURNISHINGS OF TOOLS, MATERIAL, ETC. by the employer is indicative of control over the worker. When the worker furnishes the tools, materials, etc., a lack of control is indicated. However, in some occupational fields, employees customarily use their own hand tools.

819. A SIGNIFICANT INVESTMENT BY A PERSON in facilities he or she uses in performing services for someone else tends to show an independent status. On the other hand, the furnishing of all necessary facilities by the employer tends to indicate the worker is an employee.

820. PEOPLE WHO ARE IN A POSITION TO REALIZE A PROFIT OR SUFFER A LOSS, as a result of their services, are generally independent contractors, while people who are employees are not in such a position. Opportunity for profit or loss may be established by one or more of a variety of circumstances, i.e., a person performing the following activities:

- a. Hires, directs and pays assistants
- b. Has his or her own office, equipment, materials or other facilities for doing the work
- c. Has continuing and recurring liabilities or obligations, and success or failure depends on the relation of receipts to expenditures
- d. Agrees to perform specific jobs for prices agreed upon in advance and pays expenses incurred in connection with the work

821. IF A PERSON WORKS FOR A NUMBER OF PEOPLE OR FIRMS AT THE SAME TIME, indications usually are an independent status exists, because the worker is usually free from control by the people or firms. However, a person may work for a number of people or firms and still be an employee of one or all of them.

822. **WORKERS WHO MAKE THEIR SERVICES AVAILABLE TO THE GENERAL PUBLIC** are usually independent contractors. Individuals may hold their services out to the public in a number of ways. They may have their own office and assistants; they may hang out a "shingle" in front of their home or office; they may hold business licenses; they may be listed in business directories or maintain business listings in telephone directories; or they may advertise in newspapers, trade journals, magazines, etc.

823. **THE RIGHT TO FIRE** is an important factor, indicating the person possessing the right is an employer. Independent contractors, on the other hand, cannot be fired as long as they produce results which measure up to their contract specifications.

Sometimes an employer's right to fire is restricted because of the employer's contract with a labor union. Such a restriction does not detract from the existence of an employment relationship.

824. **AN EMPLOYEE HAS THE RIGHT TO END THE RELATIONSHIP** with the employer at any time the employee wishes, without incurring liability. An independent contractor usually agrees to complete a specific job and is either responsible for its satisfactory completion or is legally obligated to make good for failure to complete the job.

POLICY

All state agencies are to comply with the federal regulations governing the proper classification of workers performing services.

FISCAL IMPACT

If a worker is classified and paid as an independent contractor and is later determined to be, in fact, an employee, the State is responsible to immediately place this person on the bi-weekly payroll. As the employer, the State must make all future payments for the employee's services, less the applicable involuntary deductions, through the State's payroll system. The State would then be subject to complying with the Social Security Administration's (SSA) Statute of Limitations. The SSA Statute of limitations is the prior four calendar years.

All remuneration, plus 100 percent of the applicable FICA taxation (both the employee's share and the employer's share) must be reported and paid by the employer. The Internal Revenue Service's quarterly 941 wage and tax statements would have to be revised and any additional tax developed would have to be remitted. Should additional federal taxation be due, the State would more than likely be assessed late deposit penalties. Late FICA tax deposit penalties may also be assessed.

The State could easily be confronted with additional liability for improper worker classification - to the worker, to the U.S. Secretary of Labor, to the Department of Justice, and to the Internal Revenue Service. The worker can sue the employer for the recovery of back wages, liquidated damages (an amount equal to the back wages), and the recovery of attorney fees. For willful violations of the Fair Labor Standards Act, the Department of Justice can criminally prosecute those individuals responsible for the violations. The penalty for the first offense is a fine of up to \$10,000. For subsequent violations the penalty can include a fine of up to \$10,000 and/or imprisonment for up to six months.

The Secretary of Labor has the power to initiate investigations to determine whether an employer has violated any provisions of the Act. Employees who "blow the whistle" on the employer *cannot* be retaliated against in any way by the employer. Special provisions of FLSA protect the employees.

The Internal Revenue Code empowers the IRS to assess the employer, as follows:

1. An employer may be liable for an amount equal to 1.5% of wages (3%, if no information return was filed) if the employer erroneously treated a worker as an independent contractor for income tax withholding purposes. This does not relieve the employee from liability for 100% of his or her income tax bill [IRC Sec. 3509(a)(1), (b)].
2. An employer may be liable for 20% of the worker's share of FICA tax that should have been withheld (40% if no information return was filed), if the employer erroneously treated a worker as an independent contractor for FICA tax purposes [IRC Sec. 3509(a)(2), (b)].
3. For attempts to evade or defeat employment taxes, an employer may be assessed a civil penalty equal to 100% of the total amount of the tax evaded or not collected [IRC Sec. 6672]. In addition, there is a criminal penalty of a \$100,000 fine (\$500,000 in the case of a corporation) and/or five years in prison [IRC Sec. 7201].
4. For failing to file a correct W-2 with the Social Security Administration, the employer may be penalized \$50 per form (maximum penalty, \$250,000 per calendar year) [IRC Sec. 6721].
5. A civil penalty of \$50 per statement may be imposed for willful failure to furnish correct wage and tax statements (Forms W-2) to employees [IRC Sec. 6674]. In addition, there is a criminal penalty consisting of a \$1,000 fine and/or one year in prison for willful failure to furnish W-2 forms, as required [IRC Sec. 7204].
6. Interest on past-due tax payments

ADMINISTRATIVE PROCEDURES

If worker status is unclear, contact the Office of the State Controller, Division of Statewide Payroll for further guidance and assistance. [Click here to download the IRS form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding](#) to help determine the proper worker classification.